United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL

74-1437

To be argued by
HAROLD B. LAWRENCE

United States Court of Appeals
For The Second Circuit

STEVEN FLAKS, WILLIAM J. HACKETT, ESTELLE JACOBSON, IRVING ORENSTEIN, MARTIN B. PERLMAN, SHARKLINE INDUSTRIES, INC., JACK TOPPEL and MILTON WEINGER,

Plaintiffs-Appellees,

—against—

DAVID I. KOEGEL and FLORA MIR CANDY CORPORATION,

Defendants-Appellants.

ON APPEAL FROM A JUDGMENT AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

(72 Civ. 1901)

BRIEF FOR PLAINTIFFS-APPELLEES

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ISSUES ON APPEAL

1. Did the defendants' misconduct justify the striking of their Answer?

2. Were the procedures followed in the District Court violative of defendants' rights of due process?

STATEMENT OF THE CASE

Introduction

The decision herein must rest upon examination of the facts of defendants' behavior in the court below, upon consideration of the allegations of the complaint, and consideration of the provisions (and exclusions) of Rule 37.

The basic facts are that David I. Koegel pursued a policy of studied defiance of the process and procedures of the District Court; that he had notice of and was informed respecting all proceedings; that five motions in the District Court resulted from his failure to comply with discovery requirements; and that six hearings were held before two Magistrates and the Hon. Morris E. Lasker, District Judge, with respect to discovery matters in this case.

Since Koegel controlled Flora Mir Candy Corporation completely, reference to the defendants' actionswill for the

most part be made by reference to Koegel alone.

Nature of the Action

This is an action to recover damages for fraud and deceit and for violations of Sections 5 and 17a of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 (R. 1). The summons and complaint herein were served on the defendants on May 15, 1972 (2a).

The defendant-appellant, David I. Koegel, is the principal stockholder and President of Flora Mir Candy Corporation ("Flora Mir")(157a). He and his wife, Lorna Koegel, own all of the stock of David I. Koegel Enterprises, Inc. (157a), an operating tool of the fraudulent scheme for which plaintiffs-appellees sued him. The complaint alleges in Paragraph 9 thereof that the defendants fraudulently obtained $600,000 from a group of investors, of which the plaintiffs-appellees contributed $400,000, and lists seventeen misrepresentations (R. 1, Complaint, pp. 3-6). Those which are germane to this appeal fall into three major categories:

1. Misrepresentations relating to the financial condition of Flora Mir at the time of plaintiffs-appellees' investment and relating to verification which would be furnished to the investors:

(a) that an infusion of $600,000 in working capital would enable Flora Mir to begin earning a substantial profit in approximately one and one-half years;

(b) that such sum would enable Flora Mir to meet operating expenses until then;

(c) that long term liabilities of Flora Mir did not exceed $1,300,000;

(d) that total assets of Flora Mir were not less than $3,000,000;

(e) that the combined sales volume of Flora Mir and its subsidiaries amounted to approximately $12,000,000 per annum;

(f) that a certified statement of the financial condition of Flora Mir would be furnished within a specified time and would show that it was solvent, in sound financial condition and operating profitably with a positive cash flow;

(g) that such certified financial statement would not differ substantially from unaudited financial statements exhibited to plaintiffs prior to their investment.

2. Misrepresentations relating to the proposed use of plaintiffs' money:

(a) that Flora Mir's program of merger with other candy companies was bona fide (plaintiffs contend Koegel was milking and destroying these companies);

(b) that the price paid by Flora Mir and the arrangements pursuant to which such acquisitions were consummated, had not theretofore included, and in the case of acquisitions thereafter, would not include assumption of any of the liabilities of the acquired companies;

(c) that the invested funds would be used to meet Flora Mir's operating expenses.

3. Misrepresentations that plaintiffs' money would not be used:

(a) To pay the liabilities of any business enterprise acquired by or merged with Flora Mir;

(b) for the purpose of repaying any indebtedness of Flora Mir to Koegel or to Koegel's wife;

(c) to acquire the companies at prices exceeding the value of the machinery, fixtures,

equipment and tangible assets of the companies being acquired, less the amount of any liens, security interests, mortgages and other encumbrances thereon, and that the prices paid on acquisitions up to that time had been so limited.

History of the Proceedings in the Court Below

The Interrogatories

On June 20, 1972 and on June 23, 1972, plaintiffs served written interrogatories directed to Koegel (22a) and Flora Mir (R.7), respectively. Each set consisted of 130 questions which were almost identical. The defendants-appellants complain in their brief that they have been subjected to "endless discovery demands" (Defendants-Appellants' brief, page 5) but the fact is that all of the proceedings in the court below related to the same 130 questions initially posed in June, 1972 and whose relevance is obvious in view of the misrepresentations alleged in the complaint. What has been endless is the defendants' obstinacy in refusing to make proper response in the face of plaintiffs' motion to

compel a response, made July 31, 1972 (R. 12) and plaintiffs' motions under Rule 37 made on January 4, 1973 (R. 15) and June 13,1973 (154a). All of plaintiffs' motions were granted. The defendants' answer was stricken by order dated August 22, 1973 (19a). Defendants' motion to vacate that order was denied (14a). Thereafter, defendants' counsel became disgusted with his client's behavior and withdrew from the case with the permission of the court (144a, 146a).

The defendants-appellants' lack of good faith is demonstrated by the fact that they were compelled to serve not less than four sets of responses. The fourth response was only a disclaimer of information and answered no questions (R. 19). The first three sets of responses (R. 16, 18, 20) left numerous important questions unanswered. All of the responses were served involuntarily under pressure from the court.

The defendants did not move or object to any of the interrogatories; their strategy was to tie the case up on motion practice. No response was made until after plaintiffs moved for an order directing the defendants to respond to the interrogatories (R. 12). Then a first response was made (R. 16), the deficiencies of which are analyzed

hereinafter. Some of the answers stated objections of a palpably evasive character.

The pattern followed by Koegel will be seen to embrace the following stratagems: (1) delay by the process of adjournment, deferment of action and failure to serve papers on time (stalling); (2) delay by service of incomplete and evasive responses; (3) sabotaging of the judicial machinery; (4) when other inspiration failed him, plain lying.

Stalling and Tactical Delays

As previously noted, service of the interrogatories was greeted with deep silence.

When on July 31, 1972, plaintiffs moved in the General Motion Part for an order to compel the defendants to respond to the interrogatories counsel for the defendants submitted an affidavit which stated in part that

> "The sole reason for defendants' failure to serve the required answers to the Interrogatories is that Mr. Koegel has been and is on an extended trip abroad." (R. 17, affidavit in opposition, p.2.)

An extension of time to September 11, 1972 for response was requested.

The motion was referred to Magistrate Gregory J.

Potter and a conference was had with him on October 19, 1972 (R. 15, Affidavit, p.3). It was agreed that an additional sixty days should be allowed to the defendants to furnish the responses, and this agreement was deemed to be the direction of the Court (R. 15, Exhibits "A" and "B" thereto).

No responses were furnished by December 19, 1972. On January 4, 1973 plaintiffs made their first motion to strike the answer of the defendants pursuant to Rule 37(d) (R. 15). The matter was referred to Magistrate Gerard L. Goettel, who held three hearings thereon (174a). During the course of those proceedings, Koegel defaulted in respect to other discovery proceedings.

On April 10, 1972, plaintiffs served a notice to take the deposition of David I. Koegel Enterprises, Inc., as a witness (167a). In connection with the proposed examinations, plaintiffs served a request pursuant to Rule 34 FRCP for production by Flora Mir of books, papers and records relating to its dealings with David I. Koegel Enterprises, Inc. (171a).

The subject matter of the proposed examination related in part to circumstances with respect to which the defendants had already failed to furnish information in response to interrogatories (158a), including transactions

between David I. Koegel Enterprises, Inc., and Flora Mir. The refusal of David I. Koegel Enterprises, Inc., in other words, Koegel, to submit to oral examination on these items was simply a repetition of Koegel's refusal to answer the interrogatories. Plaintiffs were thus compelled to make a second motion under Rule 37.

In order to establish a complete basis for relief under Rule 37, plaintiffs' second motion incorporated all of the matters set forth in the first motion. The notice of motion dated June 13, 1973 recites that the motion is made upon all the prior pleadings and proceedings (154a) and the prior motion papers were appended as an exhibit (159a, 173a, R. 15).

In the supporting affidavit, the Court was advised that the prior motion was still pending; that Magistrate Goettel had rendered his report recommending dismissal unless data was furnished and that he had found that defendants were not cooperating with their attorneys; and that circumstances had occurred which made it clear that the defendants intended to continue their obstructive tactics notwithstanding the outcome of the proceedings before the Magistrate (157a, 159a, 160a, 163a, 164a).

It should not be overlooked that such default occurred after a stipulation had been entered into at Koegel's request adjourning the examination of David I. Koegel Enterprises, Inc. to June 7, 1973 (179a). The stipulation had also provided for production of the records of Flora Mir on June 1, 1973 pursuant to the Request for Production dated April 10, 1973 (180a). The records produced were mostly irrelevant and were meaningless without the production of certain other records which were not produced. Defendants' attorneys produced some corporate records of Flora Mir Candy Corporation, some cancelled checks drawn on accounts of David I. Koegel Enterprises, Inc., David Koegel and Lorna Koegel, and corporate minutes of Flora Mir Candy Corporation and of David I. Koegel Enterprises, Inc., but no bank statements or check books and no accounting books and ledgers of any kind (161a, 175a).

On the morning of June 7, 1973 at about 9:30 A.M., a further adjournment of the examination of David I. Koegel Enterprises, Inc. was requested and refused (162a, 163a) and on June 13, 1974, plaintiffs made their second motion to dismiss the answer pursuant to Rule 37 (154a).

Service of Incomplete and Evasive Answers

Nothing could be more misleading than the contention repeated several times in the brief, that the dispute in question involves only four items. The true magnitude of the failure of compliance and Koegel's bad faith is made obvious by surveying what was left unanswered after service of each set of responses.

Unanswered in whole or in significant part, by the original "Answers to Interrogatories Directed to Defendants, David I. Koegel and Flora Mir Candy Corporation," sworn to by Koegel on January 26, 1973, seven months after the interrogatories had been served (R. 15, Reply Affidavit of Harold B. Lawrence; R. 16) were items

> 2, 13-15 inclusive, 17, 18, 20, 26-28 inclusive, 36, 38, 40, 42, 43, 45-48 inclusive, 50, 52-57 inclusive, 59-61 inclusive, 63, 64, 66-71 inclusive, 73-78 inclusive, 85-106 inclusive, 113-120 inclusive, 127.

The following questions were still unanswered, in whole or in significant part, after service of the "Supplemental and Amended Answers" sworn to by Koegel on March 15, 1973, nine months after the interrogatories had been served (R. 18):

> 14, 15, 18, 20, 38, 45, 46, 53, 64, 66, 67, 73, 74, 78, 85, 86, 87, 88, 89, 94, 96, 102, 115, 116, 117

The following questions still remained unanswered in whole or in significant part, after service of the "Supplemental Answers No. 2," sworn to by Koegel on May 2, 1972, eleven months after the interrogatories had been served and after service of the "Supplemental Answers to Plaintiffs' Interrogatories," dated May 7, 1973, which was merely a statement that there had been an unsuccessful search for records relating to items 86, 89, 96, 116 and 117 (R. 20 and R. 19, respectively):

14, 15, 18, 20, 38, 45, 46, 53, 64,
66, 67, 73, 74, 78, 85, 86, 87, 88,
89, 94, 96, 102, 115, 116, 117.

The defendants' evasive tactics followed several well defined patterns. Some responses disclaimed knowledge of matters which were clearly within Koegel's capacity to find out. Examples are Item 85 (whether a Flora Mir subsidiary had had a profit or a loss) (R. 20); Item 18 (data regarding litigation in which Flora Mir had been engaged, needed in order for plaintiffs to locate the court files) (R. 20); Item 64 (after initial failure to furnish any response at all disclaimer of knowledge respecting a subsidiary which Koegel had owned and had sold to Flora Mir) (R. 20).

Another pattern involved furnishing the type of data requested, but for a different year: Item 78 (R. 18, p. 15; knowledge later disclaimed, R. 20, p. 3).

In the original responses, Koegel and Flora Mir professed confusion as to which corporations were referred to in certain interrogatories. An examination of the interrogatories shows that the corporation involved in each case was clearly and obviously designated: Items 50, 57, 64, 71, 78, 85, 92, 99, 106 and 120 (R. 15, Lawrence Reply affidavit, p. 3; R. 16).

Item 14c asked whether stock of Borah Nut Company was sold to Flora Mir pursuant to oral or written agreement; response merely referred to annexed copies of stock assignments, but the question was not answered (R. 18).

Subdivision (a) of item 20 asked for the dates any indebtedness of Flora Mir to David I. Koegel Enterprises, Inc. was incurred. In the "Supplemental and Amended Answers" of March 15, 1973 (R. 18, p. 10) Koegel responded that indebtedness was incurred "between June 30, 1964 and May 30, 1968". No dates were given nor were the respective amounts of indebtedness incurred on such dates stated. Thus, a request for details of the obligations resulted

in a response in which only the aggregate amount owing was repeated and which did not indicate whether more than one note was involved, the terms of any such note, the date, face amount, date of maturity or interest rate. Inquiry as to the consideration for the indebtedness brought a response that the consideration was "cash loans". No response was given to subdivision (d)iv, which asked who acted on behalf of David I. Koegel Enterprises, Inc. That information was certainly in defendants' possession.

If these responses to item 20 take a back seat to any other response as an example of evasion, then it must be to the response to item 36 on March 15, 1973 (R. 18, p.11), quoted at page 24, in which Koegel declared it was impossible to state how much money had been loaned to Flora Mir or to any of its subsidiaries.

Koegel frequently avoided an informative response by referring to financial statements supposedly annexed to the supplemental responses. An Exhibit "G", annexed in response to items 65-71 (R. 18) consisted of semi-illegible worksheets which could not be deciphered. The information requested, relating to obligations payable and collateral was not ascertainable from the exhibit furnished.

Items 86 and 87 were answered by reference to an Exhibit "J". This was a document, the nature of which was not identified and was dated only as of February 17, 1968 and which did not furnish data requested. The same problems were encountered in the responses to items 88 and 89 (R. 18).

Sabotaging the Judicial Machinery

When plaintiffs made their second Rule 37 motion on June 13, 1974 (154a) the service of the papers crossed in the mail with notice of motion by defendants' attorneys for leave to withdraw from the case (144a). The defendants-appellants' brief insinuates a connection, without justification or support in the record.

The defendants' attorneys, in their notice of motion for leave to withdraw, dated June 12, 1973, based their motion

> "on the ground that defendants have failed to cooperate with their attorneys and further have refused to make sufficient arrangements to pay for extensive legal fees already incurred." (144a)

The supporting affidavit of Arthur S. Olick (146a) revealed a number of startling facts which provided the key to the defendants' tactics in this case. Olick first noted that the problems encountered by his law firm

in composing answers to plaintiffs' interrogatories "have been legion" (147a) and then proceeded to demonstrate that they all stemmed from David I. Koegel: it was "extremely difficult to obtain defendants' full cooperation" (147a) despite the fact that explanation of the importance of furnishing the date had been made "on numerous occasions" (147a). Mr. Olick stated that his firm "has not received the cooperation it demands of its clients, particularly, with respect to the production of answers to the numerous interrogatories propounded by plaintiffs."

Even though Koegel had refused to pay legal fees, he refused to consent to his attorneys' withdrawal from the case (148a). Koegel undoubtedly contemplated a legal deadlock which would stall the case for several months: his retained attorneys would not work and new attorneys would not be allowed in. Olick states at pages 3 and 4 of his affidavit (148a):

> "On June 7, 1973, Mr. Koegel called deponent and revoked his consent to our withdrawing from this case. He refused to obtain substitute counsel while refusing, at the same time to pay for services rendered and to be rendered. Deponent advised Mr. Koegel that this motion would be made and again urged that he find substitute counsel. He refused.***"

Judge Lasker held a hearing June 27, 1973, at which Mr. Olick and counsel for plaintiffs were present (85a). Also present was Jerome G. Goldman, Esq., who stated that he appeared for Koegel but did not represent him in this action (85a). Judge Lasker set time limits for submission of an affidavit by Koegel and set dates for determining the motion to strike defendants' answer. On June 28, 1973 Judge Lasker confirmed his instructions by letter to Koegel with copy to Goldman (85a, 87a).

It is noteworthy that Mr. Goldman advised Judge Lasker that Mr. Koegel wanted to submit facts only with respect to Olick's motion for leave to withdraw as defense counsel (86a). Judge Lasker notes this in his letter. His letter specifically stated that he probably would grant the withdrawal motion and directed Koegel to retain counsel (86a).

Koegel was thus kept advised of matters through the attorney who attended the hearing and by a letter directly from Judge Lasker.

Though Judge Lasker gave the defendants a month to respond to the Rule 37 motion (86a) no answering affidavit was submitted. Accordingly, on August 4, 1973,

Judge Lasker rendered a decision striking defendants' answer basing it on all the proceedings in the case (18a). Notice of submission of an order thereon for signature was given on August 17, 1973 to Flora Mir Candy Corporation at the address of its New York office, and to Koegel both at Flora Mir's address and at his residence address (189a, 190a).

After the order was signed on August 22, 1973 (19a) the defendants appeared through the firm of Weisman, Celler, Spett, Modlin & Wertheimer, and moved to vacate the order under Rule 60(b)(70a). In response to a request from Judge Lasker, Arthur S. Olick submitted an affidavit amicus curiae (135a) which made it obvious that there was no possibility that if the order of August 22, 1973 were vacated the defendants would be any more cooperative than they had been in the past, for his defaults were deliberate.

The Olick affidavit shows that Koegel was advised to secure new counsel as early as December, 1972 (136a); that Koegel was advised in writing that Judge Lasker had called a conference for June 27, 1973 (137a); that Koegel was advised of the order of June 21, 1973 directing service of responses to the interrogatories within twenty days and that Koegel's statement that he was never informed of the

existence of the order is untrue (138a); that in July, 1972, Koegel was warned that failure to respond to interrogatories could result in entry of a judgment against him (138a, 139a); that Koegel reviewed such responses as had been made to the interrogatories (139a); that he was advised of the various motions (139a); and that the need for information to respond to certain specific interrogatories which still remained unanswered had been called to his attention (139a, 140a).

After reciting at length the numerous communications by letter, telephone and telegram urging Mr. Koegel to cooperate, in Paragraph 9 of his affidavit, Mr. Olick states the following (141a):

> "We were not furnished with all of the information required to provide full and complete answers; we were furnished with sometimes inadequate data; we were furnished with sometimes conflicting information; and, in each case, the answers to the interrogatories were carefully reviewed with Mr. Koegel and he approved the same in all respects. . . In each case and with each interrogatory and with each document he was consulted and pressed for information."

Mr. Olick places the responsibility squarely where it belongs (143a):

> "Suffice it to say that Mr. Koegel was at all times advised in a timely fashion of his responsibilities, the requirements for information

> to answer interrogatories and the necessity to appear for deposition. There were no last minute crises except such as were occasioned by Mr. Koegel's unavailability."

Lying

1. The defendants made contradictory responses with reference to matters of vital significance. In the formal responses made on behalf of both defendants to items 20 and 38 of the separate interrogatories directed to them, the defendants variously stated that the indebtedness of Flora Mir to David I. Koegel Enterprises, Inc. was evidenced by a debenture and by a series of promissory notes.

Items 20(a), (b) and (c) (34a and R. 7, p. 14) relate to a preceding interrogatory, No. 19, which inquired whether Flora Mir at any time was indebted to David I. Koegel Enterprises, Inc. This was answered affirmatively (R. 16, p.16). Item 20 sought information as to the date such indebtedness was incurred; the details of the obligations relating to face amount, date of maturity, interest rate and convertibility; and the consideration for the said indebtedness.

The response originally furnished to Item 20(b) on

January 26, 1973 (R. 16, p.16) was to the effect that David I. Koegel Enterprises, Inc. received a debenture whose terms were the same as those of the debentures issued to the plaintiffs. This was contradicted by the response to the same item in the supplemental and amended answers of March 15, 1973 (R. 18, p.10), which stated that David I. Koegel Enterprises, Inc. received, "Non-convertible, demand notes at 8% interest unsecured totaling in the amount of $192,500". This, in turn, was contradicted by the response to item 38 in the supplemental answers #2 of May 2, 1973 (R. 20, p.3), which again asserted that a debenture was given, simply stating, "See Exhibit A annexed hereto and incorporated herein."

The Exhibit "A" referred to is a lie in itself. Aside from the fact that it patently was not the document supposedly issued to David I. Koegel Enterprises, Inc., it was obvious, and Magistrate Goettel found as a fact (177a) that Exhibit "A" was a fabricated exhibit, manufactured by deleting the name of a payee from another debenture. The photocopy furnished appears to have had something superimposed upon it in order to delete the name of the payee. A request for inspection of the original document was refused (118a).

The inconsistent answer and exhibit were duly noted in the report and recommendation of Magistrate Goettel (177a).

2. Koegel made misstatements of fact to the District Court.

In his affidavit (95a) submitted in support of his application to vacate the order of August 22, 1973, Koegel made the following statements:

> "At no time did my prior attorneys ever inform me of the existence of such an Order . . ." (reference being to the order of June 21, 1973) (98a).
>
> "If there was any inadequacy in any of the Answers to the aforementioned four Items of Interrogatories, the responsibility for same lies with my prior attorneys who were provided with all of the information required to answer same fully and adequately." (100a)
>
> "I affirm that all information necessary to answer these four Interrogatories completely had previously been turned over to my former lawyers." (100a)
>
> "4. I have previously made every good faith effort to provide my prior attorneys with all information necessary for them to prepare full and complete Answers to the Interrogatories served by the plaintiffs. . . only 4 Interrogatories out of 130 separately numbered Interrogatories propounded to each defendant were not adequately answered by the defendants." (98a, 99a)

Either he lied in making these statements or he

lied in his "Supplemental Answers No. 2," sworn to May 2, 1973 (R. 20, pp. 1-3), in which he swore that, because he could not locate records, he did not furnish his attorneys with data necessary to respond to Interrogatories numbered 14(c), 15(d), 15(e), 18, 46, 53, 64, 67, 73, 74, 78, 85, 87(d), 87(e), 88, 94, 102 and 115.

In his response to Interrogatory No. 36 on March 15, 1973 (R. 18, p. 10) he had said,

> "(a) It is impossible to determine exactly how much money was lent to Flora Mir Candy Corporation or to any of the other corporations named in these Interrogatories."

3. Defendants furnished responses to some interrogatories which contradicted allegations made in the petition of Flora Mir Candy Corporation in its Chapter XI proceeding (120a).

4. The defendants failed to produce or seek for records or explain their absence in any satisfactory fashion.

Such records had been available in the Chapter XI proceedings and were turned over to the debtor at the conclusion of such proceedings in 1971 by order of Referee Babitt; at that time they had been in good order (118a-121a).

POINT I

THE MISCONDUCT OF THE DEFENDANTS AFFORDED ABUNDANT JUSTIFICATION FOR THE SANCTIONS IMPOSED.

The court below did not ask the defendants to do anything that was impossible or extraordinarily difficult, or even to do it quickly. Far from showing inadvertency, excusability or impossibility, Koegel has demonstrated that his conduct followed a clearly discernible pattern of willful and deliberate defaults as standard operating procedure; the furnishing of contradictory responses; failure to furnish any plausible explanation for the absence of books and records; the fairly obvious lack of any sincere effort to find records which were asserted to be unavailable and furnishing responses to interrogatories which were at variance with statements made elsewhere and which amounted to plain misstatements of fact.

The report of Magistrate Gerard L. Goettel, made on May 22, 1973 (174a) confirms this.

Magistrate Goettel, after three hearings determined that the defendants had not adequately explained the absence of pertinent books and records, whose disappearance

was "puzzling" (175a); belated objections were unsupported in defendants' papers and had been waived (176a); inadequate responses had been furnished to certain key questions (177a); that inconsistent responses and an altered exhibit had been filed (177a); and that the Court ought to assess attorneys fees in the amount of $1,000 against the defendants (177a).

The order of August 22, 1973 (19a) was signed by Judge Lasker after extended consideration of the circumstances recited in Magistrate Goettel's report (174a) and the entire fourteen-month history of the discovery proceedings , the first Rule 37 motion (R.15) having been incorporated as an exhibit and made part of the record (173a). The order striking the answer was made expressly on the basis of the material set forth in the affidavits submitted on the motion (156a, 130a), the attached exhibits, defendants' failure to comply with the order of June 21, 1973 (153a) and to respond to interrogatories, appear at scheduled depositions or respond to the present motion (19a). The record thus abundantly indicates that all of the delays were traceable to the conduct of the defendants themselves, not their attorneys, and that successive sets of deficient responses were served reluctantly under pressure from the Court.

In Transworld Airlines, Inc. v. Howard R. Hughes and Hughes Tool Company, 332 F.2d 602 (2nd Cir. 1964), this court affirmed a judgment of the District Court dismissing with prejudice the defendants' first five counterclaims and granting summary judgment in favor of the plaintiff on the sixth counterclaim because of the defendants' failure to produce certain documents and to produce the managing agent of one defendant for examination. While the judgment against the defendants was subsequently vacated on the ground that the complaint against them failed to state a cause of action as a matter of law, the decision dismissing the counterclaims indicates the proper guide in this case:

> "The sanction of judgment by default for failure to comply with discovery orders is the most severe sanction the court may apply, and its use must be tempered by the careful exercise of judicial discretion to assure that its imposition is merited. However, where one party has acted in willful and deliberate disregard of reasonable and necessary court orders and the efficient administration of justice, the application of even so stringent a sanction is fully justified and should not be disturbed." (332 F.2d 602, 614.)

Of course, the requirement of "willfulness" has since been deleted from Rule 37, so that Koegel's conduct is unquestionably within the rule and the spirit of the decisions interpreting it. In any event, his conduct is

obviously willful, and the Hughes decision cites a number of other factors justifying the sanction of dismissal of a pleading which are present in the instant case: deliberate failure to furnish information; the circumstance of one individual being sole owner or controlling factor in all of the transactions under scrutiny; the fact that the deposition of the particular individual not produced or the information not furnished is essential to the proper conduct of the litigation; the protracted nature of the litigation (more than one year); and its drain on the energies, finances and resources of the parties and counsel.

Koegel's argument that a lesser sanction should have been imposed ignores the fact that initially a lesser sanction was imposed (order of June 21, 1973 and fine of $1,000). The following comment made in the Hughes decision pertains to that very point (332 F.2d 602, 615):

> "In the light of all these circumstances the District Court was not obliged to employ sanctions less severe than the dismissal of the counterclaims with prejudice. Whatever lesser sanctions might have sufficed with regard to the documents withheld by the defendants, it seems to us that a dismissal of the counterclaims was appropriate, in view of Hughes' intransigence after intensive and expensive discovery proceedings already protracted for more than one year."

Inconsistent and evasive answers to interrogatories have, of course, been strongly condemned because they demonstrate dishonesty and an attempt to frustrate the progress of the action.

In Norman v. Young, 422 F.2d 470 (10th Cir. 1970), the defendants demonstrated their bad faith by inconsistent statements in the fashion of Mr. Koegel as to the existence of documents requested on production. First, they advised the court that certain tax returns requested did not exist and thereafter produced wholly worthless documents purporting to be the tax returns; after admitting on deposition that requested records were in the hands of an accountant, defendant later tried to assert that they did not exist. The court's comment is directly in point (422 F.2d 470, 473):

> "By the nature of the documents requested, plaintiff provided a prima facie case of existence and control by the motion for production. Oral excuses were legion but never did defendants deny in writing (until after default) that the documents existed. Having failed to properly deny that which was presumed to exist, defendants failed to comply with the order. And, thereby, the court could presume existence in a concealed state and/or that the evidence they would provide would show the untruth or unmeritorious nature of the defense."

Jones v. Uris Sales Corporation, 373 F.2d 644 (2nd Cir. 1967), was a stockholder's derivative action in which this court upheld the sanction of entry of default judgment on facts similar to those of the present case. The history of the case features all the highlights of the present case: started and adjourned examinations; dilatory production of papers, and then only partial production; a defendant too busy traveling to attend depositions; instances of total failure to produce records; directions from the court directing appearance and production of records, but at extended dates to meet the defendant's convenience; warnings by the court, in the form of a conditional order striking the answer. At the end, the court granted plaintiff's motion to strike the defendant's answer. The district court's judgment was affirmed by this court with modifications not pertinent here. Much as Koegel has done in the present case, that defendant stalled discovery for about one year and was given numerous opportunities by the District Judge to produce the required documents despite his obnoxious conduct. Like Koegel, he finally exhausted the patience of the court.

In U.S. for the Use of Weston & Brooker Company v. Continental Casualty Company, 303 F.2d 91 (4th Cir. 1962) the defendant's answer denied everything except the jurisdictional allegations of the complaint but its answers to written interrogatories admitted half of the debt alleged in the complaint. Sanctions imposed after late service of defendant's answers to additional interrogatories were upheld on appeal. The inconsistency between the answer and sworn responses established that the defendant was not honestly complying with disclosure.

The forbearance of the trial court may properly end at the point at which the court becomes convinced of the evasive defendant's bad faith and his failure to comply with discovery thereafter. Pioche Mines Consolidated, Inc. v. Dolman, 333 F.2d 257 (9th Cir. 1964).

Michigan Window Cleaning Co. v. Martino, 173 F.2d 466 (6th Cir. 1949), was an action to recover overtime compensation under the Fair Labor Standards Act of 1938, in which plaintiffs sought from the defendant-employer the work records necessary to establish plaintiffs' claims and responses to interrogatories. In affirming the entry of a default judgment, the Circuit Court stated (173 F.2d 466, 467):

> "The court concluded that the appellant [the defendant/employer] had made every attempt to frustrate and defeat its mandated purpose of determining the sums due the respective claimants; that appellant's course of conduct indicated that it was deliberately trying to confuse and impede progress; that its failure to make any attempt to give adequate and complete answers to the interrogatories left it with no alternative but to enter the order of default."

A defendant cannot provoke the court into imposing a sanction by flouting the court's procedures and then argue to an Appellate Court that the District Court's impatience became exhausted prematurely. Both Diaz v. Southern Drilling Corp., 427 F. 2d 1118 (5th Cir. 1970), and Peitzman v. City of Illmo, 141 F.2d 956 (8th Cir. 1944), sounded warnings that parties who provoke an inevitable response with full awareness of the effects of their actions will not be heard to complain. In Diaz v. Southern Drilling Corp., 427 F.2d 1118, 1127 the court summed up the attitude as follows:

> "Appellant failed to appear not once but three times, without good cause being shown. Each time it failed to give any advance warning and offered no viable alternative for the taking of the deposition. . . Here appellant was in a position not only to see the sword of Damocles hanging over its head but to watch as the events it set in motion sawed at the thread securing the sword. Prudence, if not a willingness to respect the trial court's orders, should have prompted it to move in some direction. Thus, the default judgment

> was a foreseeable and appropriate response to Trefina's refusal to act, and we hold that the trial court did not abuse its discretion in ordering it."

Mr. Koegel has offended against the federal discovery rules in ways which clearly bring this case within the rules laid down by the cases cited. He has evaded duly noticed examinations as in the Diaz and Peitzman cases, he has failed to respond properly to interrogatories as in the Michigan Window case; and he has failed to produce documents requested and has made inconsistent or unconvincing statements in regard to the documents requested, as in the Norman and Uris cases.

POINT II

THE DEFENDANTS WERE AFFORDED AMPLE OPPORTUNITY TO BE HEARD AT EVERY STAGE OF THE PROCEEDINGS IN THE DISTRICT COURT AND THERE WAS NO VIOLATION OF DUE PROCESS.

The defendants' arguments that they were deprived of due process rest on contentions, firstly that they received inadequate notice or none at all at various critical stages of the proceedings in the court below and thus were deprived of opportunity to be heard; and, secondly, that they

were not granted such opportunity when requested. These simply are not the facts of the case, as the record makes clear.

There is an additional argument, made mostly by implication, that somehow the court exceeded the authority to impose sanctions which is actually conferred by Rule 37. This argument is disposed of by the comment of the Supreme Court in Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers, 357 U.S. 197, 209 (1958):

> "In our opinion, whether a court has power to dismiss a complaint because of noncompliance with a production order depends exclusively upon Rule 37, which addresses itself with particularity to the consequences of a failure to make discovery by listing a variety of remedies which a court may employ as well as by authorizing any order which is 'just'."

The court proceeded to excuse the default of the plaintiff for the reason that his conduct was of a type precisely the opposite of the conduct which Koegel has exhibited in this case, noting that plaintiff's failure to comply with a production order "was due to inability fostered neither by its own conduct nor by circumstances within its control" (357 U.S. 197, 211, 212). Noncompliance in the

Societe Internationale case was found to have occurred "despite good faith efforts, to comply with a pretrial production order" (357 U.S. 197, 210).

1. Adequate Hearings Held

An attempt to get Koegel to attend one of the hearings before Magistrate Goettel was resisted by Koegel's counsel (132a, 133a). Nevertheless, the defendants-appellees now assert that their answer was stricken without benefit of a hearing. In fact, there were six hearings in the District Court and Koegel and Flora Mir were represented by counsel at all of them.

(1) On October 19, 1972, a hearing was held before Magistrate Potter (174a) in connection with plaintiffs' first motion, in which plaintiffs sought an order directing the defendants to answer the interrogatories. Kreindler, Relkin, Olick and Goldberg, Esqs., defendants' attorneys of record, appeared for them.

(2)-(4) On February 23, 1973, a hearing was held before Magistrate Goettel in connection with plaintiffs' second motion (174a), in which plaintiffs sought an order striking the defendants' answer for failure to respond to

the interrogatories. Magistrate Goettel held two additional hearings on this motion, on March 19, 1973 and April 17, 1973 (15a, 174a). Kreindler, Relkin, Olick and Goldberg, Esqs. appeared for the defendants at all of these hearings.

(5) On June 27, 1973, Judge Lasker held a hearing in chambers (85a). Plaintiffs had made their second motion (154a) to strike the answer (their third motion relating to discovery) and Kreindler, Relkin, Olick & Goldberg, Esqs. had moved (144a) for leave to withdraw from the case by reason of defendants' failure to cooperate. Arthur Olick appeared on behalf of his firm and Jerome E. Goldman, Esq. appeared for the defendants (85a).

(6) On September 25, 1973, Judge Lasker heard argument on the motion under Rule 60(b) to vacate his order of August 22, 1973. David G. Shapiro, Esq. was thereafter substituted and submitted an affidavit on behalf of the defendants (R. 37).

As to notices of proceedings, the record shows that Judge Lasker wrote a letter to Koegel on June 28, 1973, clearly advising him of pending developments (85a). Arthur Olick notified Koegel of the order of July 21, 1973 (138a); and advance notice of submission of

the proposed order which was signed on August 22, 1973 was given to the defendants by plaintiffs' counsel (16a, 189a).

In any event, it was entirely within Judge Lasker's province to decide whether an oral hearing was needed to determine the question before him. Rule 43(e), FRCP, sets forth the governing procedure:

> "(e) Evidence on motions. When a motion is based on facts not appearing of record the court may hear the matter on affidavits presented by the respective parties, but the court may direct that the matter be heard wholly or partly on oral testimony or depositions."

Judge Lasker specifically directed Mr. Koegel to submit any additional information which he wanted to call to Judge Lasker's attention in affidavit form by July 20, 1973 (86a). Mr. Koegel's failure to submit any affidavit conclusively demonstrates that there were no additional facts not already before Judge Lasker which he could adduce at an oral hearing. Having flouted the opportunity given to him to present affidavits, he cannot now complain that he was deprived of due process because there was no oral hearing.

It has also been noted previously that Rule 37 no longer requires a showing of willful default.

If the Rule presently required such a showing, then a hearing possibly would have been advantageous to the court in order to observe the demeanor of the defendant and to determine whether his default has been willful or not. But with the removal of this requirement from Rule 37, there was no need for yet another hearing and there was more than enough before Judge Lasker, in the record, in the affidavits and in the Report and Recommendation of Magistrate Goettel dated May 22, 1973 (174a) to enable him to make a decision.

2. Koegel received notice of the order of June 21, 1973.

The defendants' then attorney, Arthur Olick, stated under oath in an affidavit filed with Judge Lasker, that he gave the defendant Koegel notice of the order (138a). However, the question of service of the order is immaterial, inasmuch as it is obvious from his subsequent conduct that Koegel would not have served responses if a copy of the order had been served upon him. Koegel did nothing when a copy of the proposed order for dismissal of his answer was served upon him on August 17, 1973; he waited till judgment was about to be entered.

3. Koegel was represented by counsel throughout the proceedings.

Koegel received notice from his own counsel to obtain new counsel as early as December, 1972; he had adequate time to obtain new counsel and failed to do so (16a, 18a, 136a). They moved for leave to withdraw in June, 1973. Koegel had been advised of the conference with Judge Lasker, scheduled for June 27, 1973 (137a). On June 28, 1973, Judge Lasker gave Mr. Koegel an additional month to get new counsel to put in opposition to the motions pending before him (86a). No showing of inability to obtain new counsel has been made by Mr. Koegel. On the contrary, the subsequent history of this case indicates that Koegel has no trouble securing counsel. Since Mr. Olick retired from the case, Mr. Koegel has been represented in this action by Weisman, Celler, Spett, Modlin & Wertheimer, David G. Shapiro, Marcus & Angel, and Roth, Carlson & Spengler.

The fact that no counsel technically represented the defendants as of July 21, 1973, is not significant, for counsel were present at all of the six hearings previously described and affidavits on the 60(b) motion were placed before Judge Lasker by David G. Shapiro and Weisman,

Celler, Spett, Modlin & Wertheimer, respectively.

4. <u>This is not a proper case for the exercise of leniency</u>.

In a proper case, the courts are and should be lenient, but each case depends upon its own facts. In this case, the court must contend with the following:

(a) The fact that Koegel was sued for commission of an outrageous fraud.

(b) The aggravated and deliberate nature of his conduct in evading discovery.

(c) Koegel's clear defiance of the orders of the District Judge and Magistrates.

(d) The enormous prejudice which has resulted to the plaintiffs thereby.

(e) The fact that the defendants deliberately created their own predicament as to lack of counsel and "unavailability" of books and records, two conditions which Koegel could easily have solved.

(f) The documented failure of the defendants to cooperate with their own counsel.

(g) Koegel's obvious lack of veracity.

5. Setting aside the judgment will not promote disposition on the merits.

The Federal Rules of Civil Procedure, Rules 26 et seq., provide for discovery proceedings in order to bring out all the facts of the cases before the court. When all the facts are known, cases can be decided on their true merits. The sanctions provided by Rule 37 are provided in order to put teeth into the rules and to make sure that parties afford each other the opportunity to get the information which will promote just and meritorious disposition. The history of the first fourteen months of this case amply demonstrates Koegel's determination that the facts shall not be disclosed and that this action shall be stalled until he has made himself judgment proof.

6. Numerous material interrogatories remain unanswered.

The defendants-appellants assert to this Court of Appeals that only four immaterial questions remained unanswered (Defendants-Appellants' brief pages 8, 15). A large number of questions remain unanswered to this day, and their materiality can be gauged merely by reading

the list of misrepresentations alleged in the complaint (R. 1; complaint, p. 3).

The defendants-appellants indirectly concede the relevance of the four interrogatories which they concede remain unanswered (20a-c, 38, 45b and 66b) by asserting a lack of "direct" relevance to the plaintiffs' claim (Defendants-Appellants Brief, page 15). These interrogatories relate directly to financial transactions between Flora Mir and Koegel (items 19, 20, 37, 38 at 34a, 37a and 38a, and 44, 45 and 66 at 40a, 41a and 47a) and to the transactions between Flora Mir and certain subsidiaries (items 45 and 65). They are directly relevant to the misrepresentations which Koegel made to the plaintiffs and which are alleged in the complaint and summarized at page 3, supra.

7. Koegel was subject to sanction for the failure of David I. Koegel Enterprises, Inc. to appear for examination.

As previously noted, Koegel absolutely controlled the corporate witness. Koegel argues that a witness's default does not count, but it must be remembered that because only Koegel could testify as to

the affairs of David I. Koegel Enterprises, Inc., and he needed an adjournment, the defendants, by their attorneys, stipulated on May 10, 1973 to submit David I. Koegel Enterprises, Inc. for examination as a witness in the action and to produce documents early in June, 1973. This stipulation was the act of the defendants. The default was the act of the defendants.

The argument that a witness, rather than a party, defaulted is on the same level as the argument that several sets of responses had been furnished. As previously noted, four sets of responses had to be served by Koegel because of the gross incompleteness and evasiveness of each prior set of responses that had been served. Evasive responses are expressly treated as a nullity by the express provisions of Rule 37(a)(3).

CONCLUSION

The order denying defendants' motion under

Fed. R. Civ. Pro. 60(b) and the judgment should be affirmed.

Respectfully submitted,

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ADDENDUM

TEXT OF RULE 37 OF THE FEDERAL RULES OF CIVIL PROCEDURE

(a) Motion for order compelling discovery. A party, upon reasonable notice to other parties and all persons affected thereby, may apply for an order compelling discovery as follows:

(1) Appropriate court. An application for an order to a party may be made to the court in which the action is pending, or, on matters relating to a deposition, to the court in the district where the deposition is being taken. An application for an order to a deponent who is not a party shall be made to the court in the district where the deposition is being taken.

(2) Motion. If a deponent fails to answer a question propounded or submitted under Rules 30 or 31, or a corporation or other entity fails to make a designation under Rule 30(b) (6) or 31(a), or a party fails to answer an interrogatory submitted under Rule 33, or if a party, in response to a request for inspection submitted under Rule 34, fails to respond that inspection will be permitted as requested or fails to permit inspection as requested, the discovering party may move for an order compelling an answer, or a designation, or an order compelling inspection in accordance with the request. When taking a deposition on oral examination, the proponent of the question may complete or adjourn the examination before he applies for an order.

If the court denies the motion in whole or in part, it may make such protective order as it would have been empowered to make on a motion made pursuant to Rule 26(c).

(3) Evasive or incomplete answer. For purposes of this subdivision an evasive or incomplete answer is to be treated as a failure to answer.

(4) Award of expenses of motion. If the motion is granted, the court shall, after opportunity for

(B) An order refusing to allow the disobedient party to support or oppose designated claims or defenses, or prohibiting him from introducing designated matters in evidence;

(C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party;

(D) In lieu of any of the foregoing orders or in addition thereto, an order treating as a contempt of court the failure to obey any orders except an order to submit to a physical or mental examination.

(E) Where a party has failed to comply with an order under Rule 35(a) requiring him to produce another for examination, such orders as are listed in paragraphs (A), (B), and (C) of this subdivision, unless the party failing to comply shows that he is unable to produce such person for examination.

In lieu of any of the foregoing orders or in addition thereto, the court shall require the party failing to obey the order or the attorney advising him or both to pay the reasonable expenses, including attorney's fees, caused by the failure, unless the court finds that the failure was substantially justified or that other circumstances make an ward of expenses unjust.

(c) Expenses on failure to admit. If a party fails to admit the genuineness of any document or the truth of any matter as requested under Rule 36, and if the party requesting the admissions thereafter proves the genuineness of the document or the truth of the matter, he may apply to the court for an orderrequiring the other party to pay him the reasonable expenses incurred in making that proof, including reasonable attorney's fees. The court shall make the order unless it finds that (1) the request was held objectionable pursuant to Rule 36(a), or (2) the admission sought was of no substantial importance, or (3) the party failing to admit had reasonable ground to believe that he might prevail on the matter, or (4) there was other good reason for the failure to admit.

hearing, require the party or deponent whose conduct necessitated the motion or the party or attorney advising such conduct or both of them to pay to the moving party the reasonable expenses incurred in obtaining the order, including attorney's fees, unless the court finds that the opposition to the motion was substantially justified or that other circumstances make an award of expenses unjust.

If the motion is denied, the court shall, after opportunity for hearing, require the moving party or the attorney advising the motion or both of them to pay to the party or deponent who opposed the motion the reasonable expenses incurred in opposing the motion, including attorney's fees, unless the court finds that the making of the motion was substantially justified or that other circumstances make an award of expenses unjust.

If the motion is granted in part and denied in part, the court may apportion the reasonable expenses incurred in relation to the motion among the parties and persons in a just manner.

(b) Failure to comply with order.

(1) Sanctions by court in district where deposition is taken. If a deponent fails to be sworn or to answer a question after being directed to do so by the court in the district in which the deposition is being taken, the failure may be considered a contempt of that court.

(2) Sanctions by court in which action is pending. If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b) (6) or 31(a) to testify on behalf of a party fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule or Rule 35, the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:

(A) An order that the matters regarding which the order was made or any other designated facts shall be taken to be established for the purposes of the action in accordance with the claim of the party obtaining the order;

(d) Failure of party to attend at own deposition or serve answers to interrogatories or respond to request for inspection. If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b) (6) or 31(a) to testify on behalf of a party fails (1) to appear before the officer who is to take his deposition, after being served with a proper notice, or (2) to serve answers or objections to interrogatories submitted under Rule 33, after proper service of the interrogatories, or (3) to serve a written response to a request for inspection submitted under Rule 34, after proper service of the request, the court in which the action is pending on motion may make such orders in regard to the failure as are just, and among others it may take any action authorized under paragraphs (A), (B), and (C) of subdivision (b) (2) of this rule. In lieu of any order or in addition thereto, the court shall require the party failing to act or the attorney advising him or both to pay the reasonable expenses, including attorney's fees, caused by the failure, unless the court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust.

The failure to act described in this subdivision may not be excused on the ground that the discovery sought is objectionable unless the party failing to act has applied for a protective order as provided by Rule 26(c).

(e) Subpoena of person in foreign country. A subpoena may be issued as provided in Title 28 U.S.C. §1783, under the circumstances and conditions therein stated.

(f) Expenses against United States. Except to the extent permitted by statute, expenses and fees may not be awarded against the United States under this rule.

As amended Mar. 30, 1970, eff. July 1, 1970.

Service of ~~three (3)~~ Two (2) copies of the within Brief is hereby admitted this 11th day of June, 1974

.....

Attorney(s) for

COPY RECEIVED
SPENGLER CARLSON GUBAR & CHURCHILL
ATTORNEYS FOR _____
DATE 6/11/74

D. Teller
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